

**DEPARTMENT OF STATE REVENUE**  
**LETTER OF FINDINGS NUMBER 99-0298**  
**SALES AND USE TAX**

**For Tax Periods: 1995-1997**

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning specific issues.

**Issues**

**1. Sales and Use Tax- Trailers and Fuel**

**Authority:** IC 6-2.5-3-2 (a), IC 6-2.5-5-3, IC 6-8.1-5-1 (b), 45 IAC 2.2-5-10 (c), 45 IAC 2.2-5-8, *Gross Income Tax Division v. National Bank and Trust Co.*, 79 NE 2d 651 (Ind. 1948), *Indiana Department of Revenue v. Cave Stone*, 457 NE 2d 520 (Ind. 1983).

The taxpayer protests the imposition of tax on trailers and fuel used to transport sawmills to branch offices.

**2. Sales and Use Tax- Weiming Knife Grinder and Grinding Wheels**

**Authority:** IC 6-2.5-5-3, 45 IAC 2.2-5-8 (h) (1), *Rotation Products v. Department of State Revenue*, 690 NE 2d 795 (Ind. Tax 1998).

The taxpayer protests the imposition of tax on the Weiming Knife Grinder and grinding wheels.

**3. Sales and Use Tax- Bander Machine and Strapper Machine**

**Authority:** IC 6-2.5-5-3, 45 IAC 2.2-5-8 (d).

The taxpayer protests the imposition of tax on the Bander Machine and Strapper Machine at the end of the production line of new band saw blades.

**4. Sales and Use Tax- Purchases on which North Carolina Sales Tax was Paid**

**Authority:** IC 6-2.5-5-3.

The taxpayer protests the imposition of tax on purchases on which North Carolina sales tax was paid.

**5. Sales and Use Tax- Rental of Gas Storage Tank**

**Authority:** IC 6-2.5-5-3, 45 IAC 2.25-8 (c)(3).

The taxpayer protests the imposition of tax on the rental of a gas storage tank.

**6. Sales and Use Tax- Parts and Equipment to Sharpen Customers' Band Saw Blades**

**Authority:** IC 6-2.5-5-3.

The taxpayer protests the imposition of tax on parts and equipment to sharpen customers' band saw blades.

**7. Sales and Use Tax- Item Listed Twice in the Audit**

**Authority:** IC 6-2.5-3-2.

The taxpayer protests the listing of an item twice in the audit.

**8. Sales and Use Tax- Calculation of Error Percentage**

**Authority:** IC 6-8.1-4-2 (b).

The taxpayer protests the error percentage used in the audit.

**9. Tax Administration- Penalty**

**Authority:** IC 6-8.1-10-2.1, 45 IAC 15-11-2 (b).

The taxpayer protests the imposition of the negligence penalty.

**Statement of Facts**

The taxpayer is an Indiana corporation that engages in the business of manufacturing portable band saw mills, blades, sawmill options and accessory products. After an audit, the taxpayer was assessed additional sales and use tax, interest and penalty. The taxpayer protested this assessment and a hearing was held. Further facts will be provided as necessary.

**1. Sales and Use Tax- Trailers and Fuel**

### **Discussion**

Pursuant to IC 6-2.5-3-2 (a), Indiana imposes an excise tax on tangible personal property stored, used, or consumed in Indiana. A number of exemptions are available from use tax, including those collectively referred to as the manufacturing exemptions. All exemptions must be strictly construed against the party claiming the exemption. *Gross Income Tax Division v. National Bank and Trust Co.*, 79 NE 2d 651 (Ind. 1948). IC 6-2.5-5-3 provides for the exemption of “manufacturing machinery, tools and equipment which is to be directly used by the purchaser in the direct production, manufacture, fabrication . . . of tangible personal property.” In *Indiana Department of Revenue v. Cave Stone*, 457 NE 2d 520, (Ind. Tax 1983), the Indiana Supreme Court found that a piece of equipment qualifies for the manufacturing exemption if it is essential and integral to the production process. 45 IAC 2.2-5-10 (c) further describes manufacturing machinery and tools as exempt if they have an immediate effect on the property in production.

Indiana Department of Revenue assessments are prima facie evidence that the taxes are owed by the Taxpayer who has the burden of proving that the assessment is incorrect. IC 6-8.1-5-1 (b).

The taxpayer’s first item of protest concerns the imposition of use tax on fuel and trailers used to transport saw mills to branch offices. The taxpayer produces the sawmill at the Indiana manufacturing facility. After completion at this facility, the sawmill is in two pieces. The taxpayer ships the two pieces on a specially designed trailer to its own distribution centers in other areas of the country. Trained company personnel assemble the sawmills at the distribution centers. The taxpayer contends that the fuel and trailers qualify for the directly used in direct production exemption because they transport the sawmills during an integrated production process. 45 IAC 2.2-5-8 concerns the exemption of transportation equipment.

- (2) Tangible personal property used for moving finished goods from the plant after manufacture is subject to tax.
- (3) Transportation equipment used to transport work-in-process or semi-finished materials to or from storage is not subject to tax if the transportation is within the production process.
- (4) Transportation equipment used to transport work-in-process, semi-finished, or finished goods between plants is taxable, if the plants are not part of the same integrated production process.

Pursuant to this theory, most of the construction of the sawmills takes place in the Indiana facility and then the remaining construction takes place in the taxpayer’s distribution offices. The taxpayer contends that it is not the mere assembling of the parts of the sawmill but actual production of the sawmills. In support of this contention, the taxpayer states that trained persons with special equipment must assemble the sawmills so that they are calibrated properly. The taxpayer then argues that the fuel and trailers used to transfer the parts of the sawmills between the production facility and the distribution facility qualify for exemption as transportation between two integrated production process stations comparable to the exemption of a conveyor belt between two production stations within one facility.

The taxpayer's argument that the trailers and fuel qualify for the transportation in an integrated production process exemption is not persuasive. In this situation there are not two plants as stated in the Regulation clarifying when transportation would qualify for exemption. Rather, the production facility is in Indiana and the other facilities are distribution centers. Some buyers pick up the sawmills and transport the totally assembled sawmill from the Indianapolis facility. Some purchasers assemble their sawmills. The transportation of the sawmills to the distribution centers is not truly part of an integrated production system. Rather the sawmills are totally produced at the Indiana facility. They are stored in Indiana and then transported to centers for distribution to customers. The sawmills are not transported between stations in an integrated production system as required by the law and regulation to qualify for exemption.

### **Finding**

The taxpayer's first point of protest is denied.

## **2. Sales and Use Tax- Weiming Knife Grinder and Grinding Wheels**

### **Discussion**

The taxpayer also operates a wood mill where it manufactures fine wood molding made of various hardwoods. For special orders it makes special knives to cut the molding. For standard type molding, The taxpayer may purchase or make its own knife.

The audit assessed tax on fifty per cent (50%) of the knife grinder and grinding wheels because they are used fifty per cent (50%) of the time for producing new blades and fifty per cent (50%) of the time for sharpening of blades. The auditor assessed tax on the fifty per cent (50%) of the use for sharpening blades on the theory that sharpening blades is routine maintenance. The taxpayer contends that the total use of the items qualifies for exemption pursuant to the directly used in direct production of a manufactured product exemption pursuant to IC 6-2.5-5-3 because the sharpening is actually the production of a blade. This exemption is clarified in the Regulations at 45 IAC 2.2-5-8 (h) (1) as follows:

Machinery, tools, and equipment used in the normal repair and maintenance of machinery used in the production process which are predominantly used to maintain production machinery are subject to tax.

The taxpayer cites *Rotation Products v. Department of State Revenue*, 690 N.E.2d 795 (Ind.Tax 1998) in support of its contention that the knife grinder and grinding wheels qualify for the manufacturing exemption as directly used in direct production. In that case, Rotation Products took worn out and useless ball bearings and performed several complicated processes on them and processed them into usable ball bearings which were comparable to new ball bearings. The Court found that this was actually a production process and materials directly used in the direct production of the reworked ball bearings qualified for a manufacturing exemption from the use tax. The taxpayer contends that the process of sharpening the blades to specific standards is so precise that it constitutes processing rather than mere maintenance as in the usual situation involving the sharpening of blades.

In deciding the *Rotation Products* case, the Court considered the extensive work done to the ball bearings to change them from a useless item to a new and marketable product, a ball bearing. The taxpayer's case does not meet that standard. Rather it is more like the repeated dry cleaning of items which allows the items to be reused within their normal life cycle which the Court cited as a taxable form of maintenance. The taxpayer did not sustain its burden of proving that the sharpening of the blades transformed them into entirely new marketable products. Rather the sharpening merely perpetuates the useful life of the blades. Therefore the sharpening is a maintenance function. As such the materials used in that maintenance function do not qualify for the exemption.

### **Finding**

The taxpayer's protest is denied.

### **3. Sales and Use Tax- Bander Machine and Strapper Machine**

#### **Discussion**

At the end of production of bandsaw blades, the taxpayer bands the blades so that they can be packed in boxes for shipping. The taxpayer then straps the boxes to pallets for shipping. The taxpayer contends that the machines which band the bandsaw blades for packaging in the boxes and the strapper machine qualify for exemption pursuant to the manufacturing exemption found at IC 6-2.5-5-3 and clarified at 45 IAC 2.2-5-8 (d) as follows:

Pre-production and post-production activities. "Direct use in the production process" begins at the point of the first operation or activity constituting part of the integrated production process and ends at the point that the production has altered the item to its completed form, including packaging, if required.

The machine that bands the saws for packing in the box affects the band saw blades prior to the end of the production process as it is defined in the Regulation. The box the band saw blades are placed in is the packaging that the Regulation clearly considers the end of the production process. Therefore this machine has the necessary effect on the product during the production process and qualifies for exemption.

The other machine straps the boxes to the pallets. At the time this machine operates, the band saw blades have already been placed in the required final packaging. This machine is used after the completion of the production process as it is defined in the regulation. Therefore this machine does not qualify for exemption.

### **Finding**

The protest to the tax imposed on the banding machine is sustained. The protest to the tax imposed on the strapping machine is denied.

#### **4. Sales and Use Tax- Purchases on which North Carolina Sales Tax was Paid**

##### **Discussion**

The taxpayer protests the assessment of tax on certain items on which the taxpayer paid the four per cent (4%) sales tax to North Carolina. The taxpayer paid the tax on some of the computers and computer supplies that it purchased from a company in North Carolina. The taxpayer accepted delivery of the items in Indiana and the sale was completed here. Therefore, the retail transaction is subject to the Indiana sales and use tax rather than the North Carolina sales and use tax. The use of the items in Indiana is subject to the Indiana use tax pursuant to IC 6-2.5-3-2(a). Therefore the Indiana use tax is the tax that is properly due and owing.

##### **Finding**

This point of the taxpayer's protest is denied.

#### **5. Sales and Use Tax- Rental of Gas Storage Tank**

##### **Discussion**

The audit assessed use tax on the taxpayer's rental of a storage tank. The taxpayer agrees that the rental of the tank would be subject to the use tax if it stored a raw material. The taxpayer contends, however, that the tank actually stores oxygen for use in a plasma cutter. The taxpayer contends that the gas is not just a raw material but is actually used in the taxpayer's production process and therefore qualifies for exemption. The taxpayer contends that this storage tank is comparable to the storage tanks for lubricating and coolant fluids example considered exempt in the Regulations at 45 IAC 2.25-8-(c) (3) as follows:

The following types of equipment constitute essential and integral parts of the integrated production process and are, therefore, exempt. The fact that such equipment is built in a manner to service various pieces of exempt equipment, as an alternative to building the equipment into each of the pieces of exempt machinery, is not determinative.

(A) Pumping and filtering equipment and related tanks and tubing used to supply lubricating and coolant fluids to exempt drilling and cutting machinery.

The taxpayer did not sustain its burden of proving that the supply tank in this case is actually analogous to the tanks supplying lubricating and coolant fluids to exempt drilling and cutting machinery referred to in the example. Rather, the tank in question appears to be a taxable storage tank.

##### **Finding**

This point of the taxpayer's protest is denied.

**6. Sales and Use Tax- Parts and Equipment to Sharpen Customers' Band Saw Blades**

**Discussion**

The taxpayer protests the assessment of tax on parts and equipment used to sharpen customers' band saw blades. Customers send dull band saw blades to the taxpayer who then sharpens the blades, boxes the blades and delivers the sharpened blades to the customer. The taxpayer argues that these items qualify for the directly used in direct production exemption pursuant to IC 6-2.5-5-3.

As in the previous discussion of the Weimig knife grinder and grinding wheels, these parts and equipment are used to maintain the band saw blades and allow them to be utilized throughout the normal life cycle of the existing band saw blades.

**Finding**

This point of the taxpayer's protest is denied.

**7. Sales and Use Tax- Item Listed Twice in the Audit**

**Discussion**

The taxpayer contends that it was assessed use tax on each of two listings of one item, 415 6410-410 IN, in the audit. Pursuant to IC 6-2.5-3-2(a), use tax is imposed on tangible personal property purchased in a retail sale and used in Indiana. There is no provision for the use of any one item to be subjected twice to the use tax.

**Finding**

The taxpayer's protest is sustained subject to audit verification.

**8. Sales and Use Tax- Calculation of Error Percentage**

**Discussion**

Pursuant to IC 6-8.1-4-2 (b), the Indiana Department of Revenue has the authority to audit taxpayers to determine if taxes were properly paid. In this case, the auditor employed a sampling and projection method to determine taxpayer's proper tax liability. The auditor used 1997 as the base period to develop the error percentage and applied this ratio to the 1995 and 1996 tax periods. The taxpayer protests the projection method used by the auditor to determine general purchases subject to additional use tax for 1995 and 1996. The taxpayer argues that the 1997 ratio overstates the error rate for 1995 and 1996 because of internal accounting issues present in 1997 that were not present during the prior years. The taxpayer further contends that the mistaken error percentage in 1997 is evidenced by the taxpayer's higher self-assessment of use tax in 1995 and 1996 as compared to 1997.

The auditor's worksheet concerning the determination of the error percentage is page 62 of the audit. This worksheet clearly shows that the taxpayer was given credit for all use taxes actually accrued and paid in 1995 and 1996. Therefore, the auditor's computation took any accounting issues into effect and properly reflects the tax for each of the years 1995 and 1996.

### **Finding**

The taxpayer's protest is denied.

## **9. Tax Administration- Penalty**

### **Discussion**

Taxpayer's final point of protest concerns the imposition of the ten per cent negligence penalty pursuant to IC 6-8.1-10-2.1. Indiana Regulation 45 IAC 15-11-2 (b) clarifies the standard for the imposition of the negligence penalty as follows:

Negligence, on behalf of a taxpayer is defined as the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer. Negligence would result from a taxpayer's carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by the Indiana Code or department regulations. Ignorance of the listed tax laws, rules and/or regulations is treated as negligence. Further, failure to read and follow instructions provided by the department is treated as negligence. Negligence shall be determined on a case by case basis according to the facts and circumstances of each taxpayer.

The audit report assessed use tax on many clearly taxable items such as brooms, oil pads and office supplies. This breach of the taxpayer's duty to properly accrue and remit use tax on taxable items constitutes negligence.

### **Finding**

This point of the taxpayer's protest is denied.